

October 27, 2011

Chairman Booher and Members of the Senate Banking and Financial Institutions Committee,

Thank you for the opportunity to testify today on behalf of the Michigan Credit Union League & Affiliates in regard to the changes to the interchange fees for debit cards. There are a few issues we'd like to speak to with regard to this matter. Many of you may recall that back in February of this year, we testified before this committee in support of Senate Resolution 14, which we felt would address small issuer concerns with the Federal Reserve's debit interchange fee regulatory proposal, Docket No. R-1404. The resolution specifically urged Congress to stop or delay the implementation of the debit interchange cap amendment, Section 1075 from the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, so that statutory changes could be made to ensure institutions with less than \$10 billion in assets are exempted without consequence in order to ensure consumers do not experience increased fees at exempted institutions.

By way of background, Section 1075 of Dodd-Frank required the Federal Reserve to issue regulations that would provide for reasonable debit interchange fees for electronic transactions and place limitations on payment card network restrictions. Institutions with less than \$10 billion in assets were specifically exempted from this provision. One issue that we brought to this body earlier this year, was that while Congress intended to protect small issuers with an exemption, we remained concerned about the lack of enforcement within the Federal Reserve's proposal to ensure that small issuers would not be subjected to the structure developed for large issuers with regard to the cap. This would have been likely if Visa and MasterCard were unwilling to create a two tiered network-one for the smaller issuers that were allowed to charge a higher rate of interchange and another for the larger issuers that fell under the interchange cap.

But beyond needing Visa and MasterCard to create a two tiered network, we also argued that even though smaller issuers could charge a higher interchange rate, there was nothing in the proposed rule that would prevent merchants from influencing consumers to use large issue debit cards at the point of sale, creating an environment where credit union issued cards would appear to be unfavorable in comparison. This was predicated on the fact many merchants currently already steer consumers to enter their PIN when they swipe their debit card instead of running it as a signature based transaction. The interchange cost to the merchant is less through a PIN based transaction. Therefore, the merchants have proven they are able to direct consumers to their preferred network with the lowest interchange.

Because of these numerous concerns, US Representative Shelley Moore Capito (R-West Virginia) and US Senator Bob Corker (R-Tennessee) had introduced legislation to provide a delay of the Federal Reserve's proposed rule on debit interchange in order to allow for time to study the impact of Section 1075 on consumers, debit card issuers and merchants, and for Congress to address potential changes to the law as a result of this study. Unfortunately, even with the support of Michigan's Legislature via resolutions urging Congress to delay the rule in order to stop, study, and start over on the debit interchange issue, the US Senate failed to adopt the amendment.

In addition to not only our concerns with the exemption of smaller issuers working in practicality, we have long argued the fact that because of the government's price cap on debit interchange fees, consumers could see new or higher fees on checking accounts and other financial services. We

maintained this position based on the sheer fact that the interchange fee enables and supports the convenience of debit cards as a valuable feature of a checking account. Each time an individual uses their debit or credit card, a merchant not only is paid immediately, but is also guaranteed payment, and the card issuer receives interchange through the card payment system. This interchange reflects a merchant's fair share of the costs of this convenient and beneficial payment system. At banks and credit unions alike, interchange supports everything from re-issuing cards compromised by merchant data breaches to providing a call center to contact if a card is lost or stolen.

Since the interchange income will be reduced because of government intervention in debit interchange fees, we argued this would likely result in costs shifting from merchants to consumers through increased fees. Financial institutions are still required to pay for data breaches and other costs associated with operating the electronic payments network – to cover these costs, many financial institutions not exempted from the interchange provision are implementing new fees to maintain their debit card income.

While many of these predictions are coming true in the marketplace for larger card issues, the full effect on smaller issuers like community banks and credit unions is still unknown. There may be short term opportunities for these financial institutions to pick up new members so long as they are able to keep their fees lower and continue to offer free checking accounts in many cases. However, we are still unsure of how this will affect small issuers in the long term since the rule has only been effect since the beginning of October. Although Visa and MasterCard have agreed to operate a two tiered network for the time being, we are unsure of what the future will hold for network structures and their sustainability. We do continue to fear that credit unions, because of their restrictive capital structure (a credit union's only source of capital is the retention of earnings), may also likely be forced to pass along these losses to their members or abandon debit card programs altogether. In the end, market forces will almost certainly put downward pressure on the higher interchange rates allowed for small issuers, proving the small issuer exemption meaningless.

The facts are the cost of providing debit cards has increased for all financial institutions over \$10 billion in assets, and now consumers have to bear the costs of paying for financial services that previously were offered for free. We urged Congress to reconsider their proposal in order to have time to effectively study the effects on consumers and to further discuss the potential unintended consequences. Since this unfortunately did not happen, many of us fear we are seeing just the beginning of what some of those negative unintended consequences look like.

Again, we thank you for your time today to discuss this matter and the concerns that still surround the debit card interchange issue. We again offer our thanks to the Committee for acting on Senate Resolution 14 in an attempt to urge Congress to do the right thing by revisiting the policy to ensure small issuers were not affected.

Sincerely,

A handwritten signature in cursive script that reads "Marcia Hune". The signature is written in dark ink and is positioned above the typed name and title.

Marcia Hune  
Vice President of Governmental Affairs  
Michigan Credit Union League & Affiliates